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IN THE

Supreme Court of the United States

October Term, 1964

No. [redacted] 74

KATHERINE F. MILLER,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

JOSEPH M. DE TOTA,
Petitioner.

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit.

CHARLES S. WILCOX,
Counsel for Petitioners,
5 South Fitzhugh Street,
Rochester, N. Y. 14614.

THE REPORTER COMPANY, INC., Walton, N. Y.—UN 5-4181—1964

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JOSEPH M. DeTOTA,

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vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit entered in this case on February 13, 1964.

Opinions Below.

The opinion of the Tax Court (R. 4a-12a) is reported at 39 T.C. 505, and is printed in Appendix B hereto.

The opinion of the Court of Appeals (R. 35a-47a) is reported at 327 F. 2d 846 and is printed in Appendix A hereto.

Jurisdiction.

The judgments of the Court of Appeals were entered on February 13, 1964, at approximately twelve o'clock noon (R. 48a-51a). No order respecting a rehearing or extension of time to petition for certiorari was made. Jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

Questions Presented.

1. Whether the conclusions of the Courts below as to the dominant motives with which members made contributions to the Employees Christmas Fund were supported by sufficient evidence?

2. Whether distributions to petitioners from the Employees Christmas Fund are taxable income or nontaxable gifts?

Statutes Involved.

The statutory provisions involved are as follows:

> §61. Gross income defined
>
> (a) General definition—Except as otherwise provided in this sub-title, gross income means all income from whatever source derived, including (but not limited to) the following items:
>
> (1) Compensation for services, including fees, commissions, and similar items.

Internal Revenue Code of 1954 §61(a)(1):

§102. Gifts and inheritances

(a) General rule—Gross income does not include the value of property acquired by gift, bequest, devise, or inheritance.

Internal Revenue Code of 1954 §102(a).

Statement of the Case.

Petitioners are employees of the Genesee Valley Club, a private, non-profit membership corporation with its clubhouse and grounds in Rochester, New York. In 1957, 1958, and 1959 Petitioner Miller was the head bookkeeper working in the office upstairs and Petitioner DeTota was the head waiter for the main dining rooms (Stipulations 1-4, Appendix C, pp. 34-35). In 1957 Petitioner Miller had served the Club for 13 years, and Petitioner DeTota for 33 years (Joint Exhibit 7-G, R. 24a).

The Club rules prohibit tipping of employees by members, but members are offered the opportunity to contribute to an Employees Christmas Fund (Stipulation 9, Appendix C, p. 36), for which each year at Christmas time, the Club sends a printed card to its members inviting their voluntary payments to the Fund for distribution to the employees of the Club (Exhibits 7-G, 8-H, and 9-I, R. 24a-29a). Not all members contributed to the fund in the years 1957, 1958, and 1959, but approximately sixty per cent did contribute amounts varying from $2 to $450.

In the years in question, the custom of prior years was followed. Whether a member contributed or not, and the amount of his contribution, were left to his discretion. The Club kept the fund in a separate bank account and distributed it in succeeding years at Christmas

time in accordance with a formula contained in the Club rules (Exhibit 14-N, R. 30a-34a). Distributions were made to all employees whether their jobs brought them into contact with the members or not.

In the years 1957, 1958, and 1959, Petitioner DeTota received $550 from the Christmas Fund, and Petitioner Miller received $448.40, $455, and $468 respectively. Neither of them paid income tax on these amounts, and the Commissioner assessed deficiencies against them for the years in question on the ground that the amounts distributed were taxable income.

After all administrative procedures were concluded, petitions for refunds were filed in the Tax Court of the United States, the jurisdiction of which is found in Internal Revenue Code of 1954, §7442. Trial was held in March, 1962, before Judge Austin Hoyt. No testimony was taken and the facts were presented by stipulation and joint exhibits. On December 7, 1962, Judge Hoyt decided for the respondent in both cases (R. 3a), ruling that the dominant motives of the transferors lead to the conclusion that the distributions to Club employees were income to them (R. 11a).

The Court of Appeals completely reviewed the stipulated facts presented to the Tax Court. The majority opinion found from the evidence presented to the Tax Court that the sums of money which petitioners received were "just as compensatory as ordinary tips" (Appendix A, p. 19) and were made with "an intent to reward past services and encourage the faithful performance of duties in the future" (Appendix A, p. 19) and affirmed the Tax Court. One Judge dissented from this opinion and voted to reverse the Tax Court (Appendix A, pp. 21-24).

ARGUMENT.

The conclusion of the courts below that the transferors' intentions in giving to the Employees Christmas Fund resulted in taxable income to petitioners is not supported by the evidence and conflicts with decisions of this court.

This Court has given no rigid formula or presumptive criterion for determining whether a transfer of money or property is a gift or income. In *Commissioner v. Duberstein*, 363 U.S. 278 (1960), it was said that the determination whether a transfer is taxed or not most critically turns up the transferor's intention. *Id.* at 285-86. The Court of Appeals in the instant case acknowledged the explanation from the *Duberstein* case that if the motives for transfer are essentially generous or charitable, the payment is a gift, but if the transferor has or feels a duty to pay or has received or expects to receive an economic benefit, his transfer is not a gift. *Id.* at 285. The determination, within broad legal confines, is one of fact.

The facts before the Court below, which it reviewed completely in reaching its opinions, were not those normally presented to a trier of facts called upon to determine the past intention of a party to litigation. Absent from the record in this case is any direct evidence from or concerning the transferors themselves. None of the members of the Genesee Valley Club testified to their motives in contributing (or not) to the Employees Christmas Fund. No written evidence of their attitudes or intentions was presented. No proof of the behavior of the transferors or the employees appears. All of the facts before the Court of Appeals and the Tax Court appear in the stipulated facts (Appendix C) and the stipulated exhibits (R. 24a-34a), none of which relate directly to the transferors. The question which the majority of the Court of Appeals

answered in one way and the dissent in another, was, therefore, uniquely less one of fact than one of law: whether, under these or similar facts, there can be a gift irrespective of a transferor's intent. The negative answer given below opens a broad new area of Christmas-time taxable income.

The majority of the Court of Appeals correctly stated that the burden of proof and of offering additional oral or written testimony was upon the petitioners, and the opinion reflected that testimony of the transferors would have been useful. However, the decision of the majority did not turn on a failure of proof. Three reasons from the Club rules and other written proof were found for affirming the Tax Court. This petition is addressed to the stipulated record from which those reasons were taken.

First, the Club members were found motivated by a tipping intention from the Club rule which prohibited tipping and invited contributions to the Employees Christmas Fund (Appendix A, p. 19). Second, the letters soliciting contributions from Club members and those sent to the employees with the distributions indicated that the members gave with an intent to reward past services (Appendix A, p. 19) and encourage future services. Third, the Club rule for apportionment of the contributions received to the Club employees took into account their salary and length of service (Appendix A, p. 20).

All tip cases prior to the instant case have contained facts which show a direct and proximate connection between the amount paid and the service and its quality. See, *e. g., Roberts v. Commissioner,* 176 F. 2d 221 (9th Cir. 1949); *Andrews v. United States,* 295 F. 2d 819 (Ct. Cl. 1961) (taxicab driver); *Dorothy L. Sutherland,* 32 T.C. 862 (1959) (restaurant waitress); *Nazzereno D. Cesanelli,* 8 T.C. 776 (1947) (restaurant waiter). See also

United States v. McCormick, 67 F. 2d 867 (2d Cir. 1933) (extortion-like payments to receive marriage licenses promptly). The *Roberts* case contains this language

> Actually a tip is connected directly with the service and its quality. He who tips thereby expresses * * * his gratification with the service by compensating the servant over and above the regular remuneration for the service.

Roberts v. Commissioner, 176 F. 2d at 224, which is no more than a summary of the determining principles set forth in this Court's *Duberstein* opinion.

> And, importantly, if the payment proceeds primarily from "the constraining force of any moral or legal duty" or from "the incentive of anticipated profit" of an economic nature * * * it is not a gift. And, conversely, "[W]here the payment is in return for services rendered, it is irrelevant that the donor derives no economic profit from it."

Commissioner v. Duberstein, 363 U.S. at 285.

Here, the direct link between the gratuity and the service cannot be found in the stipulated facts. Contributions were not made to employees themselves (wherever they worked), but to the Club. The payments were not made at the time services were rendered, but once a year, and the amount did not depend on the size of a dinner check, the amount of a contributor's bills, or even the amount of his use of the Club. The procedure set forth by the Club rules for distributions and the method by which contributions were received functioned to keep the employees uninformed of the identity of members who gave and the amounts contributed. Accordingly, a member contributing could not reasonably anticipate that his contribution would affect the service given to him or make it any different than the service given all other members by Club employees. He could, if he wished, gain the same result by giving nothing.

The other rationale of tip cases, spoken of as the "element of compulsion" in *Roberts v. Commissioner,* 176 F. 2d at 221, has no application to this case, for there is no question that these payments from those who gave were entirely voluntary (Appendix A, p. 15).

In its second reason for affirming the Tax Court, the Court below found that portion of the solicitation letter to members from the Club, which spoke of recognizing employees' past services, and that portion of a letter authorized by the Club rules expressing appreciation and encouragement to employees from the Club "compelling indicia" of an intent by contributors to reward past services and inspire future duties. In so finding, the Court below recognized the remote connection between transferor and recipient, but did not heed it. Yet it is only from such a link that any economic meaning can be given to words such as "reward" or "encouragement." The Court of Appeals found a link by disregarding the Club as an intermediary and agreeing with the Tax Court that

> the Genesee Valley Club was, in effect, one huge service organization. * * *

(Appendix A, p. 19). Even if it is assumed, however, that all members were the employer and that all employees served all members and that it is immaterial that neither the transferor nor the recipient knew the object or source of payments to and from the Christmas Fund, it has still been held that a payment made to an employee who has been of service which has been of general benefit is not conclusively income to him.

> Because the Unopco stockholders had benefited by the past services of the recipients, it by no means follows that the distribution in question was not a gratuity. It nowhere appears in the record that full compensation had not been made for these services. There would seem to be a natural inference to the contrary; and the inference is made

> determinate by the stipulated fact that no one was under any obligation, legal or otherwise (and this would include a moral obligation, however slight) "to pay any additional compensation." There is no ground for saying that the benefit received and the compensation then paid for it were not equivalents.

Bogardus v. Commissioner, 302 U.S. 34, 42 (1937).

However, the contributing members were not the petitioners' employers, the contributions had no connection in time or type to any services, and the Genesee Valley Club was not a business or profit-making enterprise. A voluntary transfer by one member to the large group of employees who had served all could not yield any economic return whatever, nor could a member expect it to. He could hope to express no more than his general gratitude and general satisfaction by his contribution knowing that it went to a group of people at Christmas time who made the Club a pleasant place. He might hope that his transfer would continue the pleasant atmosphere of the Club. He could expect no more, and his individual motives may have been far less. At very most the intent, found by the majority of the Court of Appeals, to reward and to encourage is equivocal, equally consistent with the compensating or profit-making intent as with the generous motives outlined in *Duberstein*. And no where did the majority of the Court of Appeals draw an inference from the compelling fact that Christmas is a time for gifts.

It is clear that the members themselves had no direct voice in the apportionment of the Christmas Fund to the employees, which the Court of Appeals found as its third and final reason for imposing income tax upon petitioners. Some Club rule for apportionment is necessary, and the one selected simply chooses one of several equitable alternatives for distribution. Gratitude, being relative, should not be made in this case to depend on an even division of the Employees Christmas Fund.

No court below has ever heard or read any evidence from or concerning the contributors to the Employees Christmas Fund themselves. It is clear that the language of the Club rules or the conduct of the Club cannot speak for the thoughts and motives of the transferors here. The issues in this case should not turn on the construction of Club rules or communications, for the motives found in those documents today can be changed to other motives by simple amendment or change of policy. If the opinion of the majority of the Court of Appeals is to have any lasting meaning, it must be taken to say that a gift as defined by *Duberstein* may not be made to one who has in the past or may in the future serve the transferor, no matter how remote the connection between them, how indefinite the possible reward or return, or what the actual motive may have been. If this is the meaning of this case now and if this case is to be followed, then the *Bogardus* case is no longer law and a presumption of taxable income has arisen in circumstances which the *Duberstein* case heretofore has called a question of fact.

CONCLUSION.

This case adds a new area of transfers to income taxation: Christmas-time payments to non-employed persons who are or have been in a service capacity. The circumstances of this case are particularly novel, however, because they involve a voluntary transfer where neither the particular transferor nor the particular recipient knew the identity of each other or the amount of the transfer nor necessarily received or rendered any specific service. Petitioners therefore respectfully request this Court to hear this case to settle its influence on the law of taxation.

CHARLES S. WILCOX, Esq.,
Attorney for Petitioners,
Office and P. O. Address,
5 South Fitzhugh Street,
Rochester, New York, 14614.

To:

JOHN F. DAVIS, Esq.,
Clerk of the Supreme Court
of the United States,
Washington 25, D. C.

ARCHIBALD COX, Esq.,
Solicitor General,
Department of Justice,
Washington, D. C., 20530.

GILBERT E. ANDREWS, Esq.,
Assistant Attorney General,
Tax Division,
Department of Justice,
Washington, D. C., 20530.

APPENDIX A.

Opinion of the Court of Appeals.

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 115-116—September Term, 1963.

(Argued November 21, 1963 Decided February 13, 1964.)

Docket Nos. 28168-28169

KATHERINE F. MILLER,

Petitioner-Appellant,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

JOSEPH M. DETOTA,

Petitioner-Appellant,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Before:

MEDINA, WATERMAN and MARSHALL,

Circuit Judges.

Petition to review decisions of the Tax Court rendered in consolidated cases, 39 T. C. 505, upholding the Commissioner of Internal Revenue's assertion of income tax deficiencies against petitioners. Affirmed.

Appendix A—Opinion of the Court of Appeals

HARRIS, BEACH, WILCOX, DALE AND LINOWITZ, Rochester, N. Y., *for Petitioners-Appellants.*
LOUIS F. OBERDORFER, Asst. Attorney General; Lee A. Jackson, Gilbert E. Andrews, Giora Ben-Horin, Attorneys, Dept. of Justice, *for Respondent.*

WATERMAN, *Circuit Judge:*

Petitioners appeal from adverse decisions of the Tax Court entered in consolidated cases on December 7, 1962, upholding the Commissioner of Internal Revenue's assertion of federal income tax deficiencies against them for the years 1957, 1958, and 1959. 39 T. C. 505. Jurisdiction to review these Tax Court decisions is conferred upon this court by Section 7482 of the Internal Revenue Code of 1954.

Petitioners argued before the Tax Court that the receipts upon which the alleged deficiencies had been based did not constitute income within the meaning of Section 61(a) of the Internal Revenue Code of 1954, because they were gifts expressly excluded from gross income by Section 102(a) of the Code. The Tax Court rejected this argument and ruled that the receipts in question had not been gifts but had been payments of a compensatory nature. We are in agreement with this ruling.

During the years of the claimed deficiencies both petitioners were employees of the Genesee Valley Club, a membership corporation in Rochester, New York, which is a social club offering to members and guests various party and recreational facilities. Petitioner Miller was the club's head bookkeeper and petitioner DeTota was a headwaiter. The deficiencies asserted against petitioner Miller amounted to $94.11, $111.04, and $122.18 for the years 1957, 1958, and 1959 respectively. Petitioner DeTota's claimed deficiencies for these years were $116.27, $122.18, and $119.33 respectively.

Appendix A—Opinion of the Court of Appeals

The asserted deficiencies were based upon sums of money both petitioners had received from the identical source and had failed to report as income. The source was a Christmas fund which the Genesee Club had maintained for its employees for many years. Financed solely through voluntary contributions solicited from members by club officials, the fund was kept by the club in a separate bank account. Shortly before Christmas each year every employee of the club was awarded a portion of the money in the fund. Not every employee received the same amount of money, however, for the size of each payment was determined by a formula that took into account each employee's regular salary and his length of service with the club. While some employees who received distributions from the Christmas fund performed tasks which brought them into direct contact with club members, many did not.

Formal authority for the maintenance of the fund, and the procedure to be followed in making payments to employees out of it, were recited in certain rules of the club's House Committee. The pertinent part of the rules relating to the fund and its distribution provided:

> J. The solicitation of contributions for the Employees' Christmas Fund and their deposit in a separate bank account. The Chairman shall supervise the allocation and distribution of this Fund by the Manager, according to the following formula:
>
> 1. A Christmas bonus shall be paid to employees from funds subscribed by members of the Club. Payments are based on points earned by each employee. Points are credited to each full-time regular employee . . . on the basis of:
>
> (a) *Length of employment*— • • •
>
> (b) *Salary*— • • •
>
> • • • • •

4. Notification of payment of bonus:

(a) Not later than December 10 of each year, the Chairman of the House Committee, after determining the point value, should send a letter to each employee outlining the basis for the bonus, and showing the number of points earned by him during the year, and the value per point. This letter should be an expression of appreciation and encouragement.

(b) Actual payment of the bonus should be made in check on December 15.

* * * * *

6. Changes in the Bonus Plan.

(a) Inequalities in any individual case which may arise in the application of this formula should be adjusted between the Chairman of the House Committee and the Manager prior to the payment of the Bonus.

In order to raise money for the fund, the club traditionally sent a notice to each of its members at Christmas time, setting forth a list of all club employees, their occupations and their years of service. Accompanying the notice was the following message:

> The Christmas Season approaches and with it the Spirit of Giving. We are sure you will welcome the opportunity to make your annual contribution to the Employees' Christmas Fund. This Fund is maintained and augmented at this time and throughout the year in order to provide tangible recognition at Christmas time of the faithful and efficient service rendered by our employees.
>
> Will you kindly designate the amount you wish to give on the enclosed card.
>
> Board of Governors.

As is apparent from this message, no member was required to contribute; and contributions were not required to be based on the amount of time a member used club facilities, or the amount of club bills he had accumulated during a year.

One of the rules of the Genesee Club required that members and guests refrain from tipping club employees, with the pertinent rule also calling attention to the Christmas Fund:

> Rule 7. No member or visitor shall give money or any gratuity to an employee of the Club. The gratuity fund provides an opportunity for all contributions.

Determining whether specific transfers are gifts within the meaning of the Internal Revenue Code cannot be resolved by resort to any fixed and precise standard. Decision in a case like this depends upon the particular circumstances surrounding the transfers in question. For this reason, most cases require that a reviewing court such as ours give "primary weight" to the conclusions of the trier of facts. *Commissioner v. Duberstein*, 363 U. S. 278, 289, 80 S. Ct. 1190, 1199 (1960); *United States v. Stanton*, 287 F. 2d 876 (2 Cir. 1961).

This particular case, however, seems to us to present an instance where this court is properly entitled to review in full the conclusions of the Tax Court. This broader scope of review is called for here because the case below was tried on facts which were entirely stipulated, and the lower court's conclusions were based entirely on documentary evidence. Under these circumstances, the factors which demand that heavy reliance be placed upon the findings of the trier of facts, see *Commissioner v. Duberstein*, 363 U. S. at 289-291, 80 S. Ct. at 1198-1200, simply do not obtain. Here no testimony was taken, and the problem of observing the demeanor of witnesses and apportioning degrees of credibility was

nonexistent. The only evidence upon which the decision below could have been based was of a type which this court is in a position to evaluate as ably as the court below. Therefore, we are permitted to review freely the decision which has prompted this appeal. *United Nations Korean Reconstruction Agency v. Glass Production Methods, Inc.*, 291 F. 2d 168, 172 (2 Cir. 1961).

Even when subjected to the more stringent test of full review, however, the Tax Court's decision to refuse to label the transfers in question as gifts must be deemed correct. While we have already noted that no hard and fast rule has been established for deciding when a transfer is a gift within the meaning of Section 102(a) of the Code, some guiding principles were laid down by the Supreme Court in *Commissioner v. Duberstein, supra.* According to the *Duberstein* case, the voluntariness of a transfer is not determinative; what controls is the intent with which the transferor executed the transfer. If a payment of the kind involved in this case proceeds from a "detached and disinterested generosity," out of "affection, respect, admiration, charity, or like impulses," it is a gift. If, on the other hand, a payment proceeds primarily from "the constraining force of any moral or legal duty," or constitutes a reward for "services rendered," or proceeds from "the incentive of anticipated benefit of an economic nature," the transfer ought not to be deemed a gift. *Commissioner v. Duberstein, supra*, at 285, 80 S. Ct. at 1196-1197.

We agree with the Tax Court that the transfers here in question were not gifts, but were, like tips or bonuses, of a compensatory nature and therefore taxable income under the internal revenue laws. If the sums which petitioners received from the Christmas fund had been received directly from club members as tips, they would have been payments in reward for services rendered, and hence taxable income. E. g., *Roberts v. Commissioner*, 176 F.

2d 221 (9 Cir. 1949). *Andrews v. United States*, 295 F. 2d 819 (Ct. Cl. 1961), *cert. denied*, 369 U. S. 829, 82 S. Ct. 846 (1962). We think that the stipulated facts in this case indicate clearly that the sums of money which petitioners received were just as compensatory as ordinary tips.

The club rule which prohibited tipping called attention to the existence of the Christmas fund and indicated that it provided "an opportunity for all contributions." The rule thus stood as a direct request to members to put money they might otherwise expend in tips into the hands of employees via the Christmas fund. Members were, in other words, asked to respond to whatever motivations prompted tipping by making contributions to the Christmas fund instead. While we recognize that some club employees performed tasks which did not bring them into direct contact with members, this fact should not merit a finding that the contributions and payments proceeded from more of a feeling of "detached and disinterested generosity" than otherwise would be the case. As the Tax Court noted, the Genesee Valley Club was, in effect, one huge service organization, and members were served just as assuredly by employees working behind the scenes as by those whose jobs brought them into direct contact with members.

Other circumstances surrounding these transfers are equally compelling as indicia of an intent to reward past services and encourage the faithful performance of duties in the future. The letter to club members soliciting contributions to the Christmas fund asked members to contribute in order to provide "tangible recognition * * * of the faithful and efficient service rendered by our empoyees." Moreover, a rule of the club's House Committee provided that the letter sent to employees explaining the computation of payments from the fund "should be an expression of appreciation and encouragement."

Finally, the method whereby the club computed the size of the payment each employee was to receive indicates that the purpose of the payment was to compensate employees for past services and encourage them to continue to perform their duties ably in the future. The size of the payments was based upon the regular salary and length of service of each employee, thereby tying fund distributions directly to services rendered to members of the club. Moreover, a rule of the House Committee provided for adjustments in the size of payments in the event of "inequalities" arising from the application of the distribution formula, indicating that employees earned the right to have payments they received compare somehow with payments which other employees received.

Petitioners also argue that we cannot rule that these payments were not gifts because the Tax Court failed to take testimony from contributors as to their reasons for contributing. While such testimony may have been helpful in determining the issue at hand, we believe that the other indicia of intent stipulated into the record more than support a finding as to the nature of the contributions. More importantly, however, since the burden of proof was on petitioners to show that they were entitled to exclude these payments from their gross income, *Gaugler v. United States*, 312 F. 2d 681, 684 (2 Cir. 1963), it was they who should have offered to introduce such testimony in evidence if they felt it could have established an intent different from that indicated by the other evidence stipulated.

Finally, we cannot turn our decision on a 1945 ruling of the Commissioner of Internal Revenue which petitioners have called to our attention, I. T. 3726, 1945 Cum. Bul. 63. Assuming that the ruling does apply to this particular set of facts, petitioners here failed to show reliance upon it by anyone involved in this case; and, at any rate, such a ruling does not commit the Commissioner, the Tax Court, or this Court, to any particular interpretation of the law. See

Helvering v. N. Y. Trust Co., 292 U. S. 455, 468, 54 S. Ct. 806 (1934); *Sims v. United States*, 252 F. 2d 434, 438 (4 Cir. 1958), *aff'd*, 359 U. S. 108, 79 S. Ct. 641 (1959). This ruling, promulgated in 1945, cannot compel us to arrive at a result different from that demanded of us by our interpretation of a later Supreme Court decision.

Affirmed.

MEDINA, *Circuit Judge* (dissenting):

"Yes, Virginia, there is a Santa Claus," wrote Francis Pharcellus Church in his famous editorial published in the New York Sun on September 21, 1897. The impulse to give generously to those less favored by fate or circumstance flourished for centuries as the Christmas Spirit moved the hearts of men. And nothing could be more natural or more human than the giving of gifts to those with whom there exists a bond of relationship, members of the family, employees or others who have helped to make the course of life run more smoothly, such as elevator boys, grocery clerks, laundresses, and a host of others. Perhaps some occasional cynic made his gift thinking only of what he might receive in return in the way of special favors. But the generality of mankind rejoiced in the thought that there truly was a Santa Claus and that he could do his bit just because it was Christmas time. Nor did it in the slightest degree detract from the essential nature of the gift that it expressed appreciation for acts of courtesy or affection or service by those in the little circle of the donor's life to whom the gifts were made.

Consistently with this almost universally recognized manifestation of good will, and uninterruptedly over the years, the individual sums paid over to the employees of private clubs from Christmas contributions by members were very properly not considered by the Internal Revenue Service to be wages and income, taxable under the Income Tax Law. No withholding for income tax

purposes was required; and these gifts were not included in the wages upon the basis of which Social Security payments were made. Indeed, this state of affairs was recognized and formalized in I. T. 3726.[1]

Suddenly came the change of policy reflected in the case before us. The effect is to create a new source of revenue, likely to run into many millions of dollars annually, all of which is taken from that class of taxpayers at the bottom of the tax ladder and least able to pay additional taxes. I raise one small voice by way of protest.

Perhaps it is already too late, for the tax gatherers have moved in swiftly. Even while this very test case was *sub judice*, and on December 12, 1963, I. T. 3726 was in effect repudiated, and the following release, TIR-527 was issued by the Service:

> "The U. S. Internal Revenue Service today announced that amounts distributed by social clubs and similar membership organizations to their employees in recognition of services are includible in the gross income of the recipients. Many such organizations make up funds from voluntary contributions or a-

[1] "Amounts distributed to employees of the M Club, a nonprofit organization, out of a Christmas Fund made up of contributions of its members for such employees and not based on services performed, constitute gifts which are not includible in the gross income of the employees nor subject to withholding under Section 1622 of the Internal Revenue Code.

Advice is requested whether amounts distributed at Christmas time to employees of the M Club, a nonprofit membership organization, are considered income and whether such amounts are subject to withholding under Section 1622 of the Internal Revenue Code.

The M Club requests its members each year to make voluntary contributions to a Christmas Fund for distribution to its employees. The total amount subscribed or paid into the fund by its members is distributed to employees of the organization at Christmas time. The contributions are not based on any services performed by the employees sharing in the benefits of the fund and the amount paid by each member is purely within the member's discretion. The organization does not treat the contributions as its own but keeps the fund earmarked 'for distribution to employees.' The organization merely acts as agent for the members in the disbursement of the funds to employees.

It is held that amounts distributed to employees, under the circumstances stated, constitute gifts and are not includible in the gross income of the employees nor subject to withholding under Section 1622 of the Internal Revenue Code."

sessments against the members of the clubs which funds are distributed to employees of the club.

The amounts distributed by the clubs to their employees constitute wages subject to withholding for income tax purposes.

Internal Revenue stated that I. T. 3726, C. B. 1945, 63, is distinguished from the circumstances described above. I. T. 3726 discusses the relatively narrow circumstances in which it can be established that Christmas distributions are gifts and not paid in recognition of any services."

The effect no doubt has been that the clubs have capitulated and there has already been widespread withholding, with what effect upon the thousands of club employees can readily be imagined. It was scarcely to be expected that club managements would do otherwise, when faced with the probability of tax claims running back as far as the applicable Statute of Limitations would permit, with the usual interest and penalties. The whole sorry business is shocking to me.

Nor is the fundamental character of these gifts affected by the inept wording of the resolution and the notices in this particular case. In all these private clubs tipping is not allowed, and the Christmas Funds are always distributed with an eye to the annual compensation and the years of service of the various club employees. It would be strange indeed if such gifts were made without any thought of appreciation for good work in the past. If this test case stands unreversed, it may be taken as established that distributions of Christmas Funds to club employees will be taxable as wages and income, no matter how the club resolutions and the notices to members are worded. Otherwise the taxability of such items would depend upon the ingenuity of tax counsel rather than upon the basic facts.

Just because no tipping is allowed, and the Christmas Fund provides club members with the only legitimate op-

portunity to give something to the club employees, it does not follow that these gifts are tips. Indeed, to my way of thinking they are the very antithesis of tips. Many of the employees, such as the man who mixes the salads and others working in the kitchen, the clerical force in the bookkeeping department and maintenance, never have any direct contact with the members of the club. It would never occur to a member to give tips to any of these people. The donors have no knowledge of how the money is distributed to the various individual employees; and not one of the employees has any knowledge of who the donors are or the amount of their respective Christmas gifts. Nor does the occasional use of the word "bonus" put this case in the category of year-end payments to executives of corporations by way of bonuses or additional salary. The two situations are as far apart as the poles.

As long as these cases are to be disposed of on the basis of stipulations, without any testimony of live witnesses, we are the fact-finders on review, as pointed out in the majority opinion. The controlling law is stated in *Commissioner v. Duberstein*, 1960, 363 U. S. 289. We are to make findings by applying our "experience with the mainsprings of human conduct to the totality of the facts" of the case. Following this rule I do not see how we can arrive at any other conclusion than to find the contributions to the Christmas Fund were gifts, and the distributions to the individual employees were not wages or income.

What disturbs me most is the assumption, lying at the base of this case, that there really is no such thing as a gift bestowed out of the goodness of one's heart and in the spirit of Christmas, but only payments of wages earned or to be earned and hypocritically called Christmas contributions. I have too much faith in my fellow man to believe that any such assumption is true.

I would reverse the decision of the Tax Court and hold the payments not to be taxable.

APPENDIX B.

Opinion of the Tax Court.

Members of a social club contribute to its Employees' Christmas Fund. The Fund is distributed to the employees as Christmas bonuses under a formula which takes into account the salary and length of service of each employee. No tipping is allowed under the rules of the Club, which call attention to the opportunity given members to contribute to the gratuity fund.

Held: Such distributions to employees are compensatory, in the nature of bonuses or tips and taxable, as income under Section 61(a) of the Internal Revenue Code of 1954.

Charles S. Wilcox, Esq., for the petitioners.
Colin C. MacDonald, Jr., Esq., for the respondent.

HOYT, Judge: The respondent determined deficiencies in petitioner Miller's income taxes for the years 1957, 1958, and 1959 of $94.19, $111.04, and $121.63, respectively. For the same years petitioner DeTota's deficiencies were determined to be $116.27, $122.18, and $119.33, respectively. The issue for decision is whether distributions from a Christmas Fund to employees of a membership club were income to the recipients within the meaning of section 61(a) of the Internal Revenue Code of 1954.

All of the facts are stipulated by the parties, are so found, and are adopted by the Court as its findings.

The petitioner, Katherine F. Miller, was employed by the Genesee Valley Club as a bookkeeper. Petitioner, Joseph M. DeTota, was employed as a headwaiter by the Club, and both petitioners filed their tax returns for the years 1957, 1958, and 1959 with the district director of interal revenue at Buffalo, New York.

The Genesee Valley Club was a membership corporation located in Rochester, New York. It was a social club

which provided eating, dancing, and party facilities for its members and guests, and, in addition, had a sports annex for squash, badminton, indoor and outdoor tennis courts, bowling alleys, and outdoor swimming pool facilities.

As is usual in such social clubs, members and guests were prohibited from tipping the Club's employees. Rule 7 of the Genesee Valley Club's rules provided as follows:

> Rule 7. No member or visitor shall give money or any gratuity to an employee of the Club. The gratuity fund provides an opportunity for all contributions.

In accordance with a long-standing custom, the Club invited voluntary contributions from its members to the Employees' Christmas Fund in 1957, 1958, and 1959. Each year a notice was sent to Club members giving a list of all employees, their occupations and their years of service, with the following message:

> THE CHRISTMAS SEASON approaches and with it the Spirit of Giving. We are sure you will welcome the opportunity to make your annual contribution to the Employees' Christmas Fund. This Fund is maintained and augmented at this time and throughout the year in order to provide tangible recognition at Christmas time of the faithful and efficient service rendered by our employees.
>
> Will you kindly designate the amount you wish to give on the enclosed card.
>
> Board of Governors.

There was no requirement that a member contribute at all or in proportion to the amount of time he used the Club or to the extent of his Club bills. In the light of well-known human traits, however, there was probably a strong correlation in some instances between the amounts

contributed and those factors. The contributions in the years in question varied as follows:

	1957	1958	1959
Total Membership	767	759	751
Number Who Contributed	533	552	565
Number Who Did Not Contribute	214	207	186
Largest Contribution	$125.00	$450.00	$140.00
Smallest Contribution	$ 2.00	$ 2.00	$ 2.00

The Fund consisted solely of contributions by the members and was deposited by the Club in a separate bank account. The amount distributed annually was determined by the amount remaining in the Fund and not by reference to the contributions expected in the current year. Many employees who received distributions from the Fund had no direct contact with Club members, whereas others did. However, all employees received some portion of the total yearly contributions. The amount each received was determined by a formula which took into consideration the salary and length of service of the employee.

The rules of the House Committee of the Club relating to this fund and its distribution provided, in part, as follows:

> J. The solicitation of contributions for the Employees' Christmas Fund and their deposit in a separate bank account. The Chairman shall supervise the allocation and distribution of this Fund by the Manager, according to the following formula:
>
> 1. A Christmas bonus shall be paid to employees from funds subscribed by members of the Club. Payments are based on points earned by each employee. Points are credited to each full-time regular employee * * * on the basis of:

(a) *Length of employment*— • • •

(b) *Salary*— • • •

• • • • • • •

4. Notification of payment of bonus:

(a) Not later than December 10 of each year, the Chairman of the House Committee, after determining the point value, should send a letter to each employee outlining the basis for the bonus, and showing the number of points earned by him during the year, and the value per point. This letter should be an expression of appreciation and encouragement.

(b) Actual payment of the bonus should be made in check on December 15.

De Tota received $500.50 from the fund in 1957 and 1958, and $507.00 in 1959, while Miller received $448.50 in 1957, $455 in 1958, and $468 in 1959. The petitioners did not report these amounts as income.

We find from the stipulated facts and exhibits that the motives of the Club and its members and the dominant reasons for the collection of, contribution to and distribution of the Club's Christmas Fund were to reward petitioners for past services rendered and induced them to continue to render good service in the future.

We also find that the gratuity fund of the Club was established under its rules as a vehicle for tipping Club employees and that payments therefrom, computed in accordance with a point formula based upon years of service and the salary of the employees, were compensatory and in the nature of bonuses or tips. They were tangible acknowledgment and reward to employees of the Club for services rendered and to induce good service in the future. In the language of the Club's House Committee rules they were in "appreciation and encouragement."

The sole issue is whether distributions from the Christmas Fund constitute "income" to the Genesee Valley Club employees within the meaning of section 61(a) of the 1954 Code.

It is clear that payments for services, even though entirely voluntary, are compensatory in nature and constitute income taxable to the recipient. In holding end-of-the-year bonuses taxable to corporate employees in *Levey v. Helvering*, 68 F. 2d 401 (C.A.D.C., 1933), affirming 26 B. T. A. 889, the Court said:

> That it was voluntary, as we have seen, does not affect its taxability The test is whether it was in payment of service. *Here it was a fixed policy of the company. It was not an isolated transaction confined to a single employee for a single year. Its amount was based on the value to the corporation of that particular officer's services to the corporation, for it was graduated on the salary schedule of the officers concerned. * * * A "gift" is a voluntary transfer of property by one to another without consideration. * * * Here there was consideration—indeed, a double consideration, viz., an acknowledgment and reward for services rendered in the preceding year, and a stimulus to continued effort and service in the ensuing year. Upon no other theory could the payments be justified, and it is not necessary nor proper to explore into an unknown field to find some other motive.* [Italics added.]

Likewise, in *Poorman v. Commissioner*, 131 F. 2d 946 (C.A. 9, 1942), the Court affirmed this Court's decision (45 B.T.A. 73) that a severance bonus was taxable income. In that opinion it was pointed out that where the salary paid was the "measuring rod" for the fixing of the additional payment, this was some evidence of its compensatory nature.

If the Christmas bonuses here had been paid to petitioners by their employer, the Club, there would appear to be no question of their taxability.

Likewise, however, tips paid by nonemployers to employees of others who serve them constitute income to the recipients, taxable as such to them. *Roberts v. Commissioner*, 176 F. 2d 221 (C.A. 9, 1949), affirming 10 T.C. 581; *Sutherland v. Commissioner*, 32 T.C. 862 (1959). Current Internal Revenue regulations, applicable to the taxable years here involved, specify that tips and bonuses (including Christmas bonuses) are income to the recipients. Income Tax Regs., 1.61-2(a) (1), promulgated by T.D. 6272, 1957-2 C.B. 18.

The petitioners here argue that since the Club did not contribute to the Christmas Fund, distributions to the petitioners did not come from their employer and cannot be compensation for services. They also contend that since many Club employees, including one of the petitioners, rendered no service to the members, and since no payments were made at the time service was rendered by some employees, the payments cannot be deemed analogous to tips or for services rendered by Club employees to members.

We cannot agree that members of a social club (a membership corporation such as the Genesee Valley Club) are not served by the entire staff of that club. Such a club is an intimate service organization and the whole staff, visible and invisible, serves the membership; the bookkeeper, the salad maker, and dishwasher serve members no less than the headwaiter. We feel that there is ample justification for the conclusion that in such circumstances distributions from a Christmas fund for club employees is nothing more or less than the paying over of an accumulation of tips at year's end.

However, there are other reasons for holding, as we must, that the payments involved here are income to the petitioners.

Appendix B—Opinion of the Tax Court

In the recent case of *Commissioner v. Duberstein*, 363 U.S. 278, 285 (1960), the Supreme Court, in a brief and luculent summary of prior decisions dealing generally with the same elusive concept of "income" here involved, said:

> if the payment proceeds primarily from "the constraining force of any moral or legal duty," or from "the incentive of anticipated benefit" of an economic nature, *Bogardus v. Commissioner*, 302 U.S. 34, 41, it is not a gift * * *. A gift in the statutory sense, on the other hand, proceeds from a "detached and disinterested generosity," *Commissioner of Internal Revenue v. Lo Bue*, 351 U.S. 243, 246; "out of affection, respect, admiration, charity or like impulses." *Robertson v. United States*, 343 U.S. at page 714. And in this regard, the most critical consideration, as the Court was agreed in the leading case here, is the transferor's "intention." *Bogardus v. Commissioner*, 302 U.S. 34, 43. "What controls is the intention with which payment, however voluntary has been made." *Id.*, 302 U.S. at page 45. [Citations partially omitted.]

The Court then went on to say that the proper criterion should be "one that inquires what the basic reason for his conduct was in fact—the dominant reason that explains his action in making the transfer."

In the case at bar there were no doubt various reasons for the contributions and the resulting distributions. Certainly the Christmas season with its spirit and atmosphere was a factor, but it was not the dominant one. As stated in Rule 7 of the Club House Rules, the gratuity Fund was the only opportunity to tip, and by the invitation of the rule itself the members deferred tipping until called upon for a contribution at the end of the year. As indicated clearly by the House Committee rules, the yardstick for measuring the amount of the Christmas bonus in each case was length of service plus salary, and the mo-

tives or reasons to be stated in the letter of advice were "appreciation and encouragement."

The fact that some Club members had no direct contact with some employees does not establish a gift, nor does it negate the compensatory nature of these payments. In the absence of [95] any rapport between the members and these employees it is difficult to find a gift motive, particularly in the light of the Club rules which clearly establish the double considerations of reward and stimulation to future service mentioned in the *Levy* case, *supra*.

In the light of the whole record, the dominant reasons or motives for the contributions and distributions were obviously to reward prior faithful service of employees of the Club to it and to its members, and to encourage the continuation of such service for the future. This leads income to the recipients, taxable as such.

The petitioners' argument that a previously issued Revenue Ruling indicates a contrary conclusion is not persuasive to change that conclusion. While IT 3726, 1945 C.B. 63, appears to be somewhat analogous to the present case on the basis of the stated facts, it does not appear therein that salary plus length of service measured the amount of the bonus. On the contrary, the ruling states that the contributions are not based on any services performed by the employees. In any event, Revenue Rulings do not have the force and effect of Treasury Department Regulations and are not binding on the Commissioner. In order to determine whether the Commissioner's determination here is proper or not, we should look to the statute and regulations. [96] *Morrison Foundry Co.*, 1 B.T.A. 413 (1925); cf. *Helvering v. New York Trust Co.*, 292 U.S. 455 (1934). Also, since that ruling was issued in 1945 there has been a considerable change in the atmosphere and complexion of the law as to the taxability of voluntarily made payments. Cf. *Commissioner v. Duberstein*, *supra*; and *Commissioner v. Lo Bue*, 351 U.S. 243 (1956).

We hold that the distributions to the petitioner-employees from the Christmas Fund of the Genesee Valley Club were actually compensatory and in the nature of tips or bonuses. A payment of such a nature, which amounts to compensation for services, however voluntary and by whatever name it is called, is still taxable income.

Decisions will be entered for the respondent.

APPENDIX C.

Stipulation of Facts.

IT IS HEREBY STIPULATED AND AGREED, by and between the parties hereto, by their respective counsel, that the following facts shall be taken as true and that the documents hereinafter described and annexed hereto shall be taken as authentic copies of the originals thereof.

1. The petitioner, Katherine F. Miller, is an individual residing at 11 Cayuga Street, Rochester 20, New York, who filed her Federal income tax returns for the taxable years 1957, 1958 and 1959 with the District Director of Internal Revenue, Buffalo, New York. Attached hereto as Joint Exhibits 1-A, 2-B and 3-C are copies of petitioner Katherine F. Miller's Federal income tax returns for the taxable years 1957, 1958, and 1959, respectively.

2. Petitioner, Joseph M. DeTota, is an individual presently residing at 67 Chestnut Street, Rochester, New York, who filed his Federal income [34] tax returns for the taxable years 1957, 1958 and 1959 with the District Director of Internal Revenue, Buffalo, New York. Attached hereto as Joint Exhibits 4-D, 5-E and 6-F, are copies of the Federal income tax returns of petitioner Joseph M. DeTota for the taxable years 1957, 1958 and 1959, respectively.

3. Petitioners were employees of the Genesee Valley Club during the taxable years 1957, 1958 and 1959. Petitioner Katherine F. Miller was employed as a bookkeeper during said taxable years and had been an employee of said Club for 15 years up to and including the taxable year 1959. Petitioner Joseph M. DeTota was employed as headwaiter in the dining room of the Genesee Valley Club during said taxable years and had been so employed for 35 years up to and including the taxable year 1959.

4. The Genesee Valley Club is a membership corporation organized and existing under the Membership Corpora-

tions Law of the State of New York. It is exempt from income tax under the provisions of Section 501(c) (7) of the Internal Revenue Code of 1954. It is a social club located in the City of Rochester, New York, and provides eating, dancing and party facilities for its members and guests and, in addition, has a sports annex which provides squash, badminton, indoor and outdoor tennis courts, bowling alleys and outdoor swimming pool facilities for the use of its members and guests.

5. In each of the years 1957, 1958 and 1959, and in conformity with a custom which has prevailed for many years prior thereto, the Genesee Valley Club invited voluntary contributions from the members of the Club to the Employees' Christmas Fund. Attached hereto as Joint Exhibits 7-G, 8-H and 9-I are copies of the notice and contribution slips sent to each member during said years.

[35] 6. Joint Exhibit 10-J [not printed] attached hereto is a correct and true statement of the total membership of the Genesee Valley Club, the number of members contributing to and the number of members not contributing to the Employees' Christmas Fund, and the largest and smallest contribution thereto for each of the years 1957, 1958, and 1959, respectively.

7. No amount was contributed to the Employees' Christmas Fund by the Genesee Valley Club.

8. The funds so received were deposited by the Genesee Valley Club in a separate bank account at the Genesee Valley Union Trust Company, Rochester, New York.

9. Rule 7 of the Club House Rules of the Genesee Valley Club provides as follows:

> "Rule 7. No member or visitor shall give money or any gratuity to an employee of the Club. The gratuity fund provides an opportunity for all contributions."

10. All employees of the Genesee Valley Club received some portion of the total yearly contributions to the Employees' Christmas Fund, including those who never had any direct contact with the members. A copy of the amounts distributed to each of the employees, and the nature of his employment, in the years 1957, 1958 and 1959 is attached hereto as Joint Exhibits 11-K, 12-L and 13-M, [not printed] respectively.

11. The amount distributed to each employee yearly was determined by a formula which took into consideration the salary of the employee and the length of service. A copy of that portion of the House Committee Rules of the Genesee Valley Club setting forth the formula used is attached hereto as Joint Exhibit 14-N.

[36] 12. On or about December 25th of each of the taxable years 1957, 1958 and 1959, petitioner Katherine F. Miller received the sums of $448.50, $455.00 and $468.00, respectively, from the Employees' Christmas Fund of the Genesee Valley Club.

13. On or about December 25th of each of the taxable years 1957, 1958 and 1959, petitioner Joseph M. DeTota received the sums of $500.50, $500.50 and $507.00 respectively, from the Employees' Christmas Fund of the Genesee Valley Club.

14. The petitioners did not report the sums set forth in paragraphs 12 and 13 above, as income in the years 1957, 1958 and 1959 for which petitioners filed timely Federal income tax returns.

15. The respondent determined deficiencies with respect to petitioner Katherine F. Miller of $94.19 for the taxable year 1957, $111.04 for the taxable year 1958 and $121.68 for the taxable year 1959. The respondent determined deficiencies with respect to petitioner Joseph M. DeTota of

$116.27 for the taxable year 1957, $122.18 for the taxable year 1948 and $119.33 for the taxable year 1959. The notices of deficiency were mailed to petitioners on July 5, 1961.

16. The petitioners filed timely petitions for redetermination with the Tax Court of the United States on September 29, 1961.

CHAS. S. WILCOX
Counsel for Petitioners
CRANE C. HAUSER
Chief Counsel
Internal Revenue Service